Service Date: June 10, 1988

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

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IN THE MATTER of the Montana Public Service Commission's Investigation of the Merger of the Pacific Power and Light Company and the Utah Power and Light Company.	)	UTILITY DIVISION DOCKET NO. 87.9.51
IN THE MATTER of the Application of PC/UP&L Merging Corp. (To Be Renamed PacifiCorp) To: (1) Issue its Common Stock and Preferred Stock to Effect a Merger with PacifiCorp and Utah Power & Light Company, (2) Assume All Debt Obligations of PacifiCorp and Utah Power & Light Company, and (3) Issue its Securities Under Authorizations Previously Granted to PacifiCorp by the Commission.	)	DOCKET NO. 87.9.49 ORDER NO. 5298a

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FINAL ORDER

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APPEARANCES

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FOR THE COMMISSION:

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BEFORE:

HOWARD L. ELLIS, Commissioner, Presiding
CLYDE JARVIS, Chairman
DANNY OBERG, Commissioner
TOM MONAHAN, Commissioner

BACKGROUND

1. On or about August 12, 1987, the Pacific Power and Light Company (PP&L) and the Utah Power and Light Company (UP&L) announced publicly that they had reached a definite agreement to merge the two companies. On August 26, 1987, Frederic Reed, a PP&L Vice President, met publicly with the members of the Montana Public Service Commission (PSC or Commission) to discuss the impacts of the proposed merger upon the rates and services offered by PP&L in its Montana service territory. At that time, Mr. Reed indicated that he did not believe that the merger would have any detrimental impacts upon PP&L's ratepayers in Montana.

2. On September 17, 1987, PP&L filed an application with the Commission for approval of the various security issuances required to effectuate the proposed merger. (Docket No. 87.9.49.) On September 28, 1987, the Commission voted to waive the 30 day deadline for consideration of such an application, extending the deadline to February 17, 1988. See § 69-3-503, MCA.

3. On October 2, 1987, the Commission issued an order initiating an independent investigation of the extent of its jurisdiction and the ramifications of the proposed merger. The Commission determined that, at a minimum, the following issues should be addressed:

1) Does the Commission have jurisdiction over the proposed merger? That is, does review of the proposed merger fall under the Commission's statutory duty to assure that ratepayers receive adequate service at reasonable rates?

2) If the Commission does have jurisdiction over the proposed merger, what further action is appropriate?

See Order No. 5298.

4. Docket No. 87.9.49 was consolidated into the investigation docket for further consideration and final disposition.

5. On October 14, 1987, the Commission received the testimony filed on behalf of PP&L supporting the proposed merger. In a cover letter with said testimony, the counsel for PP&L indicated that the Company was willing to stipulate to the Commission's jurisdiction and authority to consider whether the proposed merger is in the public interest.

6. On November 5, 1987, the Commission granted the requests of the Montana Power Company and the Montana Consumer Counsel (MCC) to intervene in this docket. On November 12, 1987, the Commission granted the intervention request of the Public Power Council.

7. On November 12, 1987, the Commission granted the request of the Colorado River Energy Distributors Association (CREDA) to intervene. Said intervention was limited to the following issues raised in the CREDA Petition for General Intervention:

1. Potential impacts of the merger on regulation and the efficiencies of the same;

2. Potential impacts of the merger on PP&L's and UP&L's cost of capital and the resultant impacts on the retail rates of the merged utility; and

3. Issues relating to PP&L's representation that the merged utility will maintain separate rates for the UP&L and PP&L divisions.

8. On November 12, 1987, direct testimony was submitted by CREDA. On November 24, 1987, the Commission received a copy of the data requests submitted by CREDA to PP&L.

9. On December 2, 1987, the Commission received a motion by PP&L to strike a portion of the filed CREDA testimony, PP&L's objections to certain data requests submitted by CREDA, and PP&L's responses to data requests submitted by CREDA. A response to the motion to strike and discovery objections was filed by CREDA on December 3, 1987.

10. On December 7, 1987, and pursuant to a Notice of Public Hearing, a hearing was held in Kalispell, Montana. Satellite public hearings were held in Kalispell and Libby, Montana, on the evenings of December 8 and 9, 1987, respectively. During the public hearing in this proceeding, the Commission denied PP&L's motion to strike and took under advisement the objections raised by PP&L to certain data requests submitted by CREDA.

11. On February 23, 1988, the Commission issued Order No. 5297a, which authorized the proposed issuance of capital stock, assumption of debt, and transfer of authority necessary to effectuate the proposed merger. This Order specifically stated that it did not constitute determination/approval of either any issuance-related ratemaking issues, or the extent of the Commission's jurisdiction, if any, over the proposed merger. See para. No. 3, Conclusions of Law, Order No. 5297a.

TESTIMONY

12. Testimony in support of the proposed merger was offered by Mr. David F. Bolender, president of PP&L. In prefiled direct testimony, Mr. Bolender offered a general description of PacifiCorp. PacifiCorp is a diversified electric utility, which last year had earnings of approximately $230 million on revenues of approximately $2 billion. PacifiCorp is one of the largest investor-owned electric utilities in the Northwest, with more than 670,000 customers in six states. In 1984, PP&L changed its name to PacifiCorp to reflect is diversification and broadened operations in electric service, telecommunications and mining. PacifiCorp continues to conduct its electric utility business under the name "Pacific Power & Light Company." During 1986, about 52 percent of PacifiCorp's operating revenues were derived from electric utility operations. All of PacifiCorp's major business segments have separate management and boards of directors. They operate as separate businesses ultimately accountable to the Chairman and Chief Executive Officer and

President of PacifiCorp, the Corporate Policy Group and the PacifiCorp Board of Directors and shareholders (PP&L Exh. 1T, pp. 2-3).

13. Mr. Bolender indicated that as President of PP&L he is responsible for PacifiCorp's electric operations and is a member of the PacifiCorp Corporate Policy Group. PP&L provides electric service to more than 240 communities through three regional offices and 54 district offices located throughout a 63,000 square mile service territory. The geographic distribution of its retail electric operating revenues during 1986 was Oregon--56 percent, Wyoming--21 percent, Washington--14 percent, California--5 percent, Montana--3 percent, and Idaho--l percent. In addition, PP&L has substantial wholesale sales for resale, principally to California utilities. During 1986, its wholesale revenues were about $128 million. On average, 70 percent of PP&L's generation comes from coal-fired plants and approximately 30 percent comes from hydroelectric facilities. PP&L also purchases substantial quantities of firm capacity and nonfirm energy from the Bonneville Power Administration (BPA) (PP&L Exh. 1T, pp. 4-5).

14. According to Mr. Bolender, the electric power industry is going through tremendous changes. Electric utilities are not only competing with their traditional rivals--oil, wood, gas and other electric suppliers, but also cogenerators, small power producers and a whole host of new emerging technologies, including fuel cells and photovoltaics. Some of these competitors are regulated, and some are not. Some enjoy tax breaks and subsidization, others do not. Competition is intensified by the power surplus now present in PP&L's service territory. Customers have more options and many parties wish to sell to them. Industrial customers in particular are shopping around actively seeking the best energy deal. As a result, electric utilities are under mounting pressure to keep prices down and quality of service up (PP&L Exh. 1T, pp. 5-6).

15. In response to this changing environment, Mr. Bolender testified that PP&L's principal concern is power sales. The Company desires to sell more of the resources it already has, in order to grow and benefit customers. However, the Company's 20-year system forecast predicts an annual growth rate of only 1.7 percent in electric sales. Accordingly, the Company is striving to force higher growth through sales and marketing, economic development, new energy services, and

mergers and acquisitions. PP&L is currently on a path of rate stability and will not be raising overall prices to customers in the foreseeable future (PP&L Exh. 1T, pp. 6-7).

16. Mr. Bolender stated that the Company believes that acquisitions and mergers can benefit new and existing customers and shareholders by allowing PP&L to use its assets more efficiently. The merger with the Utah Power & Light Co. (UP&L) is a prime example of this goal. To the extent the merger with UP&L allows for a further reduction of PP&L prices, the Company would be in a better position to retain customers. According to Mr. Bolender, PP&L believes that the merger will produce the following benefits:

a. It will increase firm and nonfirm access to existing and new wholesale power markets, facilitating the profitable disposition of available power supplies. On cross, Mr. Bolender admitted that this may eventually lead to the addition of new capacity on an accelerated basis. However, he added that the diversity of the two utilities made available an additional 430 megawatts (TR 17-18).

b. It will enhance both companies' ability, through expanded interconnections, to take greater advantage of low-cost power supplies which are available in the short term but which likely will not be available in the long term, absent an early commitment.

c. Because Pacific Power is a winter-peaking utility and Utah Power is a summer-peaking utility, there are substantial benefits to be gained from the diversity of the two systems.

d. It will reduce system operating costs through the integrated economic dispatch of generation.

e. It will reduce system reserve requirements and improve system reliability because of expanded transmission interconnections.

f. It will permit the consolidation of duplicative activities, resulting in future operating savings.

g. It will provide enhanced opportunities for employees of both companies.

(PP&L Exh. 1T, pp. 11-12.) On cross, Mr. Bolender stated that to some degree, most of these benefits could at least in part be obtained through contract as opposed to merger (TR 20-23).

17. Mr. Bolender indicated that the proposed merger reflects an extraordinary strategic and geographic fit of the two companies. PP&L has access to low-cost Northwest hydroelectric resources and the Pacific Northwest-Pacific Southwest Intertie. UP&L has a substantial transmission network and access to wholesale markets otherwise unavailable to Pacific Power. PP&L's transmission system is in a general east-west direction, while UP&L has a north-south orientation. The two companies are already interconnected at Naughton, Wyoming and additional major interconnections can be made on a cost-effective basis (PP&L Exh. 1T, p. 13).

18. Mr. Bolender also provided a brief description of the terms of the proposed merger. Both UP&L and the existing PacifiCorp will be merged into a new Oregon corporation (presently called PC/UP&L Merging Corp.). The new Oregon corporation will be renamed "PacifiCorp," contemporaneously with the merger. The outstanding shares of common and preferred stock of PacifiCorp will be converted into shares of the new corporation. The common stock of UP&L will be converted into shares of the new corporation, based on a formula derived from the PacifiCorp closing price during a ten-day computation period following final regulatory approval. Pursuant to this formula, UP&L's common shareholders will receive between .909 and .957 shares of the new PacifiCorp stock and will own more than 40 percent of the shares of the new corporation. The merger will be accomplished as a "pooling of interests" so there will be no need for any acquisition adjustment or valuation of good will. The transaction will qualify as a tax free reorganization under the Internal Revenue Code (PP&L Exh. 1T, pp. 13-14).

19. Following the merger, UP&L will operate as a separate business unit of PacifiCorp and continue to do business under the name "Utah Power & Light Company." Like PP&L, UP&L will have a separate board and will be afforded the same benefits and treatment as other business units of PacifiCorp. UP&L will play a key role in defining PacifiCorp strategy through representation on the Corporate Policy Group and PacifiCorp's Board. The merger agreement provides that two persons who are members of the Board of Directors of UP&L, and one person residing in the UP&L service territory, will be elected to the Board of Directors of the merged corporation. Thereafter, the merged corporation will seek further representation of qualified persons residing in the UP&L service territory for its Board of Directors with the aim of eventually having a pro rata representation

from that service territory. The UP&L headquarters will remain in Salt Lake City, Utah (PP&L Exh. 1T, pp. 14-15).

20. Mr. Bolender stated that it was not desirable for UP&L and PP&L to be organized as separate subsidiaries of PacifiCorp, since this would probably cause PacifiCorp to become a "holding company." On cross, however, Mr. Bolender stated that if the existing laws had been different, the merged company would have pursued a separation of distribution, transmission, and generation functions into subsidiaries (TR 56-57). Currently, operating as two divisions of the same corporation strikes the proper balance between autonomy and coordinated operations. However, Mr. Bolender indicated that a "profit center" orientation would be useful in maintaining accountability for controlling costs and lowering prices, although he added that setting retail prices on the basis of dealings between internal "profit centers" would require Commission concurrence. The merged corporation will have assets of approximately $8.7 billion (PP&L Exh. lT, pp. 16-17).

21. On cross, Mr. Bolender indicated that with regards to operations in the State of Montana, PP&L was committed to stabilizing its retail rates over the next five years. He stated that the PP&L/UP&L merger was an integral part of this commitment (TR 27).

22. Mr. Bolender further indicated that many of the claimed benefits of the proposed merger will depend upon, to some degree, the addition of new transfer capability or additional transmission. He added that the merger was not being entered into solely for the purpose of improving the wholesale market, which constitutes only 10 to 15 percent of PP&L's business (TR 29, 32). According to Mr. Bolender, PP&L viewed its retail business as a stand alone reason for seeking the merger. The increased access to wholesale sales is one of the merger benefits, but not a primary benefit (TR 29, 30).

23. Mr. Bolender described the potential problems regarding the stock dilution experienced by PP&L shareholders. He indicated that it was PP&L's belief that this dilution will be cured by increased earnings, which will result primarily from significant decreases in costs. The additional access to existing and new wholesale power markets will also be a principal source of earnings which will help cure the dilution problem (TR 42-48).

24. Testimony in support of the proposed merger was offered by Mr. Rodney M. Boucher, Vice President of Power Systems for PP&L. In prefiled direct testimony, Mr. Boucher elaborated upon the major power supply benefits expected to accrue to the merged power system. Mr. Boucher testified that the two power systems would be operated and planned on a "single utility basis." This will maximize benefits for the customers of both divisions. Arrangements will be made between UP&L and PP&L governing exchanges, economy interchange and the movement of power for various purposes. These arrangements will be developed and implemented so as to insure that the merged systems operate as efficiently as possible. This is not inconsistent with the goal of maintaining separate operating divisions, which is intended to insure that each division is responsive to customers in each area served (PP&L Exh. 3T, p. 3).

25. Mr. Boucher stated that the power system benefits of the merged system will be derived from efficiencies and economies related to resource planning and system operation. The underlying factor giving rise to efficiencies and economies is diversity, as viewed from several perspectives, including power supply mix and attendant costs, resource planning philosophy and constraints, temporal retail load characteristics and wholesale power marketing opportunities. Hydroelectric resources and capacity purchases from the Bonneville Power Administration (BPA) comprise substantial parts of PP&L's capacity resource mix, constituting about 25 percent and 18 percent, respectively. In contrast, most of UP&L's capacity is supplied by the western coal resources available to it. PP&L's location allows a more diversified resource mix, taking advantage of its access to inexpensive hydroelectric resources and resources purchased primarily from BPA. (PP&L Exh. 3T, pp. 5-6, Exh. 3, Figures 1, 2, Table 1.)

26. Similarly, Mr. Boucher indicated that there was a significant diversity between the two systems with respect to energy supply, although the relative contributions of each resource type to energy production are different. The higher contribution of PP&L's thermal generating facilities to its total energy requirements versus its total available capacity (59.2% vs. 52.4%) is largely due to the Company's BPA obligations. In UP&L's case, thermal resources contributed a smaller fraction to its energy resource mix than to its capacity mix (72.1% vs. 91.6%). This illustrates UP&L's ability to use its geographic location and transmission system to its economic advantage by importing lower

cost energy from other sources when available. (PP&L Exh. 3T, p. 6, Exh. 3, Table 2.) In addition, the energy production costs of the two systems are also diverse (PP&L Exh. 3T, p. 7, Exh. 3, Figure 3). These significant differences have resulted in the planning emphasis for PP&L to be on energy supply while UP&L has primarily focused upon capacity supply (PP&L Exh. 3T, p. 8).

27. Mr. Boucher also described the merged system's peak load diversity. PP&L's winter peaks have historically occurred during the months of November through February, while UP&L's peaks have predominantly occurred in July. On an integrated basis, the combined system peaked in the winter, and this coincidental peak is substantially lower than the sum of the two systems' noncoincidental annual peak loads. The difference, or annual peak load diversity, is 436 MW (PP&L Exh. 3T, p. 9, Exh. 3, Figures 5, 6).

28. According to Mr. Boucher, the many diversities between the two power systems translate into significant power supply benefits from the merger. First, with regard to resource planning benefits, these diversities will lower the combined system's future capacity requirements by over 350 MW. This estimate is based on projected peak load diversity, combined with seasonal differences in resource availability. Taking advantage of these diversities will postpone peak capacity purchases that would have been needed as early as 1990. Capacity resource needs are also expected to be reduced by greater reserve sharing through anticipated expanded interconnections. These interconnections will also facilitate the greater utilization of currently available power supplies from third parties, and increase the PP&L-UP&L transfer capability by 500 MW to 700 MW, at a cost of between $25 million and $40 million. On direct, Mr. Boucher indicated that PP&L and UP&L had determined that a lesser cost interconnection alternative existed, the completion of which would cost about $22,000,000 (TR 67-68). This alternative would increase transfer capability by 200 MW to 300 MW (TR 73). The merging of the systems and expanded interconnections will allow a greater use of all available resources for both long-term power needs and short-term operating efficiencies. This will promote the attainment of least-cost planning goals and objectives for both divisions (PP&L Exh. 3T, pp. 9-11, Exh. 3, Figures 7, 8). Further, in the absence of the merger, PP&L's projected energy resource requirements would out pace the Company's existing energy resources in the 1993-1994 time frame. The merging of the systems will postpone the energy needs of the

combined system until 1997-1998 (TR 68). This estimate excludes additional energy supplies that could be available as a result of either returning to service UP&L's generating units currently unavailable for use, or increased power purchases through expanded interconnections (PP&L Exh. 3T, p. 12). On cross, Mr. Boucher indicated that the merger adds no net savings to the projected energy needs of the combined companies (TR 77).

29. On cross, Mr. Boucher described in general the current transmission capabilities of the UP&L and PP&L systems. PP&L currently uses the lines of the Idaho Power Company to transmit power from the Kinport and Forest Substations to the Midpoint Substation, with total transmission and entitlement rights of 1,600 megawatts (TR 69). PP&L also uses transmission from the Colstrip project to move power from Wyoming into the northwest. The extent of this transmission capability is approximately 140 megawatts. In addition, PP&L participates in the Amps Line, from Brady, Idaho, to Hot Springs, Montana. The participation in this line varies, but is currently about 30 megawatts. Mr. Boucher indicated that many of the benefits anticipated from the merger were dependent upon increased transfer capability (TR 70-71).

30. Mr. Boucher testified that the merged Company's avoided costs should be lower than currently exist for either Company due to both the postponement of required capacity and energy resource additions and the increased availability of lower-cost resource options. Because the power systems will be operated and developed on a joint basis, it would be appropriate to propose uniform avoided cost prices in those jurisdictions where both divisions serve (PP&L Exh. 3T, pp. 12-13).

31. Mr. Boucher indicated that significant benefits to the merged system will also result from system operation. PP&L anticipates that benefits will be derived through an ability to adopt both joint unit commitment (deciding which generation facilities to make available for use) and dispatch (deciding the extent to which available resources are actually utilized). These joint operations will allow the merged system to take full advantage of fuel cost diversities and improve overall generating unit operating efficiencies, resulting in significant total fuel cost savings. In addition, PP&L will acquire additional load following capability, since UP&L's large coal-fired generating units are designed and equipped with automatic generation control (AGC) devices (PP&L Exh. 3T, pp. 13-15).

32. Mr. Boucher also described the wholesale power marketing diversities between the two existing systems, and the potential benefits for the merged system. Energy sales to California power markets have represented about 77 percent of PP&L's total wholesale energy sales over the past four years, and less than half that amount for UP&L. Conversely, UP&L's sales to desert Southwest utilities have represented about 34 percent of their total energy sales, and only about 1 percent of PP&L's sales. Wholesale power sales benefits will accrue to the merged system through increased sales margins, and through enhanced firm and nonfirm power sales opportunities. The costs associated with delivering power to wholesale customers will be lower due to operating efficiencies. Sales margins will also improve due to the combined systems' ability to offer a wider variety of valuable energy services to existing and potential purchasers, commanding better prices. Further, the expected ability of the merged system to effectively compete for wholesale power sales transactions is largely predicated on its extensive and complementary existing market access, potential future market access, and the wide variety of marketable energy services (PP&L Exh. 3T, pp. 15-18, Exh. 3, Figures 9, 10). Nonfirm power marketing opportunities will also be enhanced by the merged system's combined ability to maximize use of the total available market through joint energy supply control (unit commitment, dispatch and maintenance scheduling), through being more price competitive as a result of operating efficiencies, and through combined market access. The ability to increase sales should also be enhanced through greater overall supply reliability, which is an important factor considered by nonfirm power purchasers in their decision making process. Reliability of supply often determines which utility gets the nonfirm business as well as the ultimate sales price. However, this does not mean that the merged Company will dominate wholesale power markets, since vigorous competition will continue from other Northwest utilities with very low prices, desert Southwest utilities with major transmission interconnections, and Federal Power Marketing Agencies with significant surplus resources (PP&L Exh. 3T, pp. 20-21). On cross, Mr. Boucher generally described a few instances wherein he believed that superior "packaging" led to a contract for power sales. However, he was unable to state whether or not this allowed PP&L to charge a higher price (TR 86-87).

33. On cross, Mr. Boucher generally described the use by PP&L of the northwest/southwest intertie. PP&L's nonfirm access is determined on a day to day basis, and results from both PP&L's declaration of how much it wants to sell, and the desire of all other parties who want to utilize Bonneville's share. If the intertie is not fully loaded, PP&L would receive its total allocation. After the merger, there may be an opportunity to gain access by sharing some of the access to the east with Bonneville, and trading access to gain additional flexibility on the intertie. PP&L is currently utilizing its entire firm allocation on the intertie. Mr. Boucher indicated that he believed that the merger will not change PP&L's use of firm access. PP&L has a 300 MW share of the intertie, which is fully utilized during the day-time. Off peak, there is additional capability available. To the extent that PP&L utilizes the AC intertie, the DC intertie, and the UP&L system to make additional firm and nonfirm sales into the southwest, and if no additional transmission is built and all existing transmission is utilized, the ability of other utilities to gain access to those interties or transmission systems will be reduced (TR 88-93).

34. On cross, Mr. Boucher elaborated upon the vigorous competition from other utilities experienced by PP&L. All scheduling utilities in the Pacific Northwest will be competing with PP&L for access to BPA's transmission capacity. These include Idaho Power and Montana Power, neither of whom have an ownership share of the intertie. Other major competitors into the southwest include Arizona Public Service, Salt River Project, Public Service Company of New Mexico, and Tucson. These utilities own the transmission system from the southwest into California. Finally, both BPA and the Western Area Power Administration (WAPA) are competitors of PP&L (TR 93-97).

35. According to Mr. Boucher, approximately half to 60 percent of the power supply benefits would come from improvements either in PP&L's ability to get higher prices for the product due to an improved market or actually selling more megawatts by having access to the market at the right time (TR 98). PP&L expects that approximately $50,000,000 will be realized as total savings in 1992. Of this amount, approximately $9,000,000 will result from actual joint operating efficiencies, as opposed to increased sales. In the earlier years, these savings due to joint operating efficiencies will be less (TR 99).

36. On redirect, Mr. Boucher described the various northwest interties, as well as Pacific's rights, if any, to each of them. The northwest/southwest AC intertie is rated at 3,200 MW, of which PP&L owns 300 MW, and Portland General owns 800 MW. The northwest DC intertie is currently rated at 2,000 MW. BPA is in the process of upgrading it to 3,000 MW. PP&L has no ownership share of the DC intertie. There is a proposal for a third AC intertie with a capacity of 1,600 MW. PP&L has no share in this line (TR 123).

37. Mr. Boucher also described the transmission capabilities from the desert southwest to the California markets. This access is accomplished through a series of lines rated at a total of 5,600 MW between the Arizona system and California. Neither UP&L nor PP&L has any share of these lines. At Four Corners, UP&L has access to certain California utilities, but it does not have the ability to transmit power to California absent the cooperation of California or southwest entities. UP&L's transmission capability to Four Corners is approximately 650 MW (TR 125).

38. Testimony in support of the proposed merger was offered by Frederic D. Reed, Senior Vice President of PP&L. Mr. Reed described savings and benefits other than those in the areas of power supply and wholesale sales that will result from the merger. A consolidation of certain duplicative functions or programs within areas such as auditing, data processing, inventories, insurance, legal, shareholder relations and power plant maintenance scheduling should produce substantial savings after the merger is fully implemented (PP&L Exh. 4T, p. 2).

39. Mr. Reed also testified that interjurisdictional and intercompany allocations are among the most complex and controversial areas of utility regulation, and that PP&L is not now proposing detailed principles for intercompany allocations. Such proposals will not be made until there is a better understanding of how the merged firm operates and there is an opportunity to consult with UP&L and the seven regulatory commissions. According to Mr. Reed any such resolution will be subject to the review and approval of this Commission. An audit path will be maintained permitting the evaluation of costs and benefits associated with any joint operations (PP&L Exh. 4T, pp. 2-3).

40. Mr. Reed stated that savings resulting from merged operations will be allocated between PP&L and UP&L in a way that will afford each Division's customers benefits at least as

great as would have resulted for separate operations. Further, PP&L is not now proposing any change in the way sales to firm wholesale customers are treated for state ratemaking purposes. Finally, absent the impact of merger benefits, PP&L does not anticipate any material change in the calculation of Average System Cost (PP&L Exh. 4T, pp. 3-4). On cross, Mr. Reed indicated that if the ASC is reduced as a result of the merger, the benefits from the BPA exchange would be less. However, the retail rate for residential and farm customers will also be reduced. Customers other than residential and farm use would receive the full benefit of the reduction in cost (TR 161-162).

41. On cross, Mr. Reed quantified the impact that the two percent rate reduction to UP&L customers would have on 1986 actual firm retail sales. This was approximately $16.9 million. Similarly, the promised 5 to 10 percent rate reduction to UP&L customers could be as high as $85 million (at 10 percent). Despite these reductions, the allocation of merger benefits between divisions will be based upon a fair apportionment of costs. The promised 5 to 10 percent reduction is inclusive of the immediate 2 percent reduction, and this second round of price reductions for UP&L customers will not occur until the benefits of the merger have materialized. Mr. Reed projected that there will be a 7.5 percent price reduction for UP&L customers by 1992 (TR 136-142).

42. Mr. Reed testified that for several years after the merger, and until the merged company and the seven regulatory commissions determine appropriate allocation formulas, the merged company will be able to present data to the state commissions regarding operations of each division on a stand alone basis, and as a combined system. This will demonstrate that there are no negative benefits, and will assist in a fair apportionment of the positive benefits (TR 147). Mr. Reed stated that PP&L was committed to rate stability for its Montana customers in the foreseeable future; that if the merger benefits are not realized, the shareholder will bear the downside risk; and that any kind of detriment or damages, including the inability to obtain capital at favorable rates, would be borne by the shareholder (TR 149-150).

43. Testimony in opposition to the proposed merger was offered by Mr. Curtis K. Winterfeld, on behalf of the Colorado River Energy Distributors Association (CREDA). CREDA is a nonprofit corporation consisting of 117 electric systems serving customers in Arizona, Colorado, Nevada, New Mexico, Utah and Wyoming. CREDA's members include entities whose businesses

are directly and indirectly impacted by UP&L and PP&L. Mr. Winterfeld is an Executive Engineer with the consulting firm of R.W. Beck and Associates. In prefiled testimony, Mr. Winterfeld described three general areas of concern regarding the proposed merger: reduction in control of transmission access by third-party utilities with the resultant effect on their surplus sales and purchases; limitation of regulatory oversight; wholesale and retail rate impacts, especially due to jurisdictional cost allocations after the merger (CREDA Exh. No. 1, p. 3).

44. Mr. Winterfeld offered a general description of the characteristics of the merged entity. The merged company will control the third largest electric utility (in terms of value of utility assets) in the western United States (specifically, the planning region of the Western States Coordinating Council). In addition, it will control 28,378 miles of interconnected transmission lines strategically linking (i) the hydroelectric generating capacity in the Pacific Northwest and the coal-fired generating stations in the Intermountain Region with (ii) the fastest growing demand market for power in the region (southern California and Nevada, Arizona and New Mexico). The combined system will provide electric service to more than 1,180,000 retail customers in seven states, with an electric service territory of approximately 153,000 square miles. The combined total assets of the merged company will be $8.7 billion, representing a 176 percent increase in the size of UP&L and a 57 percent increase in the size of PacifiCorp. Further, the merged company's revenues from electric operations will nearly double to $2.057 billion after the merger (CREDA Exh. No. 1, pp. 5-6).

45. According to Mr. Winterfeld, the merger will have a significant impact on transmission access for Montana utilities and other utilities in the Western Region. UP&L's transmission is strategically located to provide access from the Pacific Northwest, Idaho, Wyoming and Montana to the inland southwestern states of Arizona and New Mexico. PP&L's east-west transmission network from the Pacific Northwest and Montana is strategically located for interconnection to UP&L in addition to PP&L's access to the southwestern states of California and Arizona. Mr. Winterfeld stated that these two factors could have several effects on transmission access, including: control of transmission access to surplus power sale markets; control of access to low-cost power supplies; reduction in the ability to obtain wheeling; and reduction in transmission

capacity of third-party facilities due to additional transfers within the merged system (CREDA Exh. No. 1, pp. 6-7).

46. Mr. Winterfeld testified that UP&L currently controls the vast majority of high-voltage transmission in the State of Utah. UP&L's transmission network in the state of Utah provides one of the major networks for access to surplus sale markets in the Southwest. The other access is the network from the Pacific Northwest into southern California and Nevada in which PP&L has considerable transfer rights. PP&L, through its acquisition of UP&L will therefore have a substantial amount of control over access to bulk surplus sale markets in the Southwest. This will tend to dilute the competitive position of other entities in Montana for access to the surplus markets in the Southwest. The added control of the transfer capability between the Pacific Northwest and the Utah region could also restrict options for access to low-cost power supplies from the Pacific Northwest for other Montana entities and reduce competition for and availability of interchange and purchase agreements between Northwest and Rocky Mountain Utilities (CREDA Exh. No. 1, pp. 7-8).

47. Mr. Winterfeld indicated that there could be significant adverse effects from the merged company's proposal to operate the combined systems on a "single-utility" basis, since the resultant effect of operating the combined system on the basis of least cost may well create increased reliance on the transmission network between the two systems. The savings anticipated by operating the systems of PP&L and UP&L on a single-utility basis will result in additional transfers between the two systems. Due to increased transfers there may be reduced system reliability. The increase in transfers could reduce the ability to isolate and mitigate the impact of generation and transmission outages (CREDA Exh. No. 1, pp. 8-9).

48. Mr. Winterfeld testified that the proposed merger may pose problems for regulatory authorities, since it is unclear how both interjurisdictional and interdivision allocations will be made (CREDA Exh. No. 1, p. 10). PP&L is not proposing any treatment for jurisdictional allocation of cost after the merger. Further, both PP&L and UP&L acknowledge that there is no immediate cost justification for the 2 percent reduction in rates to UP&L customers. This proposed reduction in rates is premised mainly on the expectation of additional bulk power sales in Western Region markets. Also, the merging companies have alluded to the possibility of operational savings due to the merger.

Mr. Winterfeld pointed out that no studies were provided which demonstrated any operational savings from the merger, and that previous testimony of the merging companies before the Utah Public Service Commission indicated that the primary source of benefits claimed by the merging companies is generated by the potential for increased sales in the regional bulk power markets (CREDA Exh. No. 1, pp. 11-12).

49. According to Mr. Winterfeld, because of the cost disparity between UP&L and PP&L, and if all other things stayed equal, the resulting merged company would be higher cost than PP&L, but lower cost than UP&L. If retail rates were set accordingly, the rates of UP&L customers would decline, while the rates of PP&L customers would increase. The merging companies have stated, however, that while rates to UP&L retail customers will decline, rates to PP&L retail customers will not increase. That scenario will hinge largely on the success of the merging companies' strategy of gaining increased sales in the bulk power markets to provide additional revenues. However, if certain conditions are placed on the merger by the Federal Energy Regulatory Commission (FERC), then the expectations of increased bulk power market sales may not be realized. Further, the evaluation of market conditions and other competitive factors at the FERC proceeding may indicate that such expectations are not realistic. If either is the case, the possible implications are that the expected revenues may not be available to offset the promised decreases to UP&L customers, which in turn will raise the rates of PP&L customers. The alternative is the possible financial deterioration of the viability of the merged company (CREDA Exh. No. 1, pp. 12-13).

50. In conclusion, Mr. Winterfeld stated that the recommendation of CREDA to the Commission is that this investigation should await further investigation and action by FERC with respect to the critical issues which can affect the public interest in Montana (CREDA Exh. No. 1, p. 14).

ANALYSIS

51. The Commission has the statutory duty to assure that ratepayers receive adequate service at reasonable rates. This duty to assure adequate service to a public utility's customers is a

broad one. Not only must that service be available tomorrow; it must also be available in the foreseeable future.

52. More specifically, the Commission's statutory duties include: The authority to supervise, regulate and control public utilities, § 69-3-102, MCA; the authority to regulate the mode and manner of all investigations and hearings of public utilities and other parties before it, § 69-3-103, MCA; the authority to "inquire into the management of the business of all public utilities," and to "keep itself informed as to the manner and method in which the same is conducted," and to "obtain from any public utility all necessary information to enable the Commission to perform its duties," § 69-3-106, MCA; the responsibility of enforcing Montana's laws as they relate to Montana's public utilities, § 69-3-110, MCA; and the authority to institute an investigation on its own motion of "rates, tolls, charges, rules, practices, and services" of a public utility, § 69-3-324, MCA. Further, utilities are required by statute to render "reasonably adequate service and facilities" at "reasonable" and "just" rates, § 69-3-201, MCA. See generally Montana Power Co. v. Public Service Commission, ____Mont.____, 671 P.2d 604 (1983).

53. The proposed merger is subject to this Commission's jurisdiction. It is clear that the proposed merger will have impacts upon Montana ratepayers. The Commission's jurisdiction over the proposed merger is not necessarily dependent upon whether the impacts are positive or negative. In both cases, a review of the proposed merger falls within the Commission's broad statutory duty to assure that ratepayers receive adequate service at reasonable rates.

54. The Commission finds, based upon the record before it, that the proposed merger is in the public interest, and therefore, should be approved. The record is replete with potential benefits resulting from the proposed merger. Further, PP&L has made a commitment to this Commission that rates for Montana ratepayers will be stable for the next five years. As part of that commitment, the Company has indicated that its shareholders will bear the downside risk of the proposed merger.

55. Because of this earnest commitment by PP&L, many of the Commission's concerns have been mitigated. In addition, the testimony of PP&L effectively refutes many of the points in opposition to the proposed merger raised by CREDA. According to CREDA, the merged company will have combined total assets of $8.7 billion, and combined total revenues of $2.057 billion. PP&L

expects that approximately $50,000,000 will be realized as total savings in 1992. Of this amount, approximately $9,000,000 will result from actual joint operating efficiencies, as opposed to increased bulk power sales. The 2 percent rate reduction for UP&L customers would result in lost revenues of approximately $16.9 million. By 1992, it is projected that UP&L customers will have received a 7.5 percent price reduction. However, no reduction to UP&L customers will occur beyond the initial 2 percent if the expected merger benefits do not materialize. Even looking at the worst case scenario, in which FERC restrictions eliminate all bulk power sales benefits, the Commission does not believe that the promised 2 percent reduction to UP&L customers will possibly lead to the "financial deterioration of the viability of the merged company."

56. CREDA also contends that the proposed merger "may pose problems for regulatory authorities, since it is unclear how both interjurisdictional and interdivision allocations will be made." PP&L is not proposing any treatment for jurisdictional allocation of costs after the merger. PP&L also stated that they were not proposing detailed principles for intercompany allocations, and that such proposals will not be made until there is a better understanding of how the merged firm operates and there is an opportunity to consult with the seven regulatory commissions. Mr. Reed indicated that any such proposals will be subject to Commission review and approval, and that an audit path will be maintained permitting the evaluation of costs and benefits associated with the merger itself and any joint operations. While CREDA raises a valid concern, the Commission believes that it is not necessary to address it in this Docket. The merger is, of course, a very complex transaction, and may result in additional complexities for state regulators. However, the Commission believes that this problem, in and of itself, is not an adequate reason to delay or prohibit the merger. Further, the Commission fully intends to direct its staff to actively participate in any meetings concerning interjurisdictional and interdivision allocations. Finally, and regardless of the results of such meetings, the adoption of any methodologies for such allocations will still be subject to review and approval by the Commission, after hearing and input from interested parties. The Commission admonishes the Company to meticulously maintain audit trails regarding costs and benefits of the merger and any joint operations, as promised. This includes costs associated with effectuating the proposed merger itself, which will be the subject of scrutiny in future rate proceedings. Further, and

as discussed by Mr. Reed, the Company should be fully prepared to present data to this Commission regarding operations of each division on a stand alone basis, and as a combined system. See Finding of Fact No. 42.

57. Mr. Winterfeld also indicated that there could be potential negative impacts from the merged Company's proposal to operate on a "single-utility" basis, since this may require an increased reliance upon the transmission network between the two systems, which in turn could reduce system reliability. Further, the increase in transfers could reduce the ability to isolate and mitigate the impact of generation and transmission outages. PP&L admits that many of the benefits anticipated from the merger are dependent upon increased transfer capability. These benefits are both tangible, in terms of increased bulk power sales, and intangible, as with increased supply reliability.

58. The Company has presented detailed plans for expanded interconnections, which would increase the transfer capability between the two systems by 200 MW to 300 MW. According to PP&L, these expanded interconnections will allow for a greater use of all available resources for both long-term power needs and short-term operating efficiencies. This will help to postpone both peak capacity and energy needs. The Commission believes that the evidence in the record does not support Mr. Winterfeld's claim of a potential for reduced system reliability. While PP&L acknowledges that increased transfers between the systems will be a result of the merger, they have also presented their plans for facilitating increased transfer capability.

59. Finally, CREDA contends that the proposed merger will have a significant impact in transmission access for Montana utilities, restricting access to surplus sale markets and low cost power supplies, as well as reducing the transmission capacity from third-party facilities because of additional transfers within the merged system. PP&L objected to this testimony on the grounds that it was outside of CREDA's limited intervention. The Commission agrees, and chooses to disregard that portion of Mr. Winterfeld's prefiled testimony commencing on page 6, line 12, and ending on page 8, line 12. The Commission notes that PP&L and UP&L have filed an application with FERC seeking approval of the merger. The FERC proceeding will undoubtedly address many, if not all, of these issues. In addition, the Montana Power Company (MPC) has intervened in this Docket and was

represented by counsel at the hearing in Kalispell. Yet, MPC chose not to actively participate in these proceedings. Without question, MPC has a strong interest in the resolution of these issues.

60. The Commission approves the proposed merger, but it is important for all parties to recognize the limited nature of this approval. The Commission specifically reserves the right to further investigate, issue public notice and hold public hearings, and rule upon matters related to the merger in the interests of Montana ratepayers. The issuance of this Order does not constitute determination or approval of any merger related ratemaking issues, specifically including but not limited to future rate and service charges, or jurisdictional and interdivision allocation determinations.

CONCLUSIONS OF LAW

1. Findings of Fact Nos. 51, 52, 53, 54, and 60 are hereby incorporated as Conclusions of Law.

2. The Pacific Power & Light Company furnishes electric service to consumers in Montana, and is a "public utility" under the regulatory jurisdiction of the Montana Public Service Commission. § 69-3-101, MCA.

3. The Commission properly exercises jurisdiction over Pacific Power & Light Company's rates and operations. §§ 69-3-102, 69-3-106, 69-3-201, 69-3-324, MCA.

4. The Commission has provided adequate public notice of all proceedings and opportunity to be heard to all interested parties in this Docket. Title 2, Chapter 4, MCA.

5. The Commission has jurisdiction over all utility activities which impact a utility's duty to render "reasonably adequate service and facilities" at "reasonable" and "just" rates. § 69-3-201, MCA.

ORDER

1. Effective immediately, the proposed merger between the Pacific Power & Light Company and the Utah Power & Light Company is approved.

2. The merged company, Pacificorp Oregon, d/b/a Pacific Power & Light Co., is hereby authorized, upon consummation of the proposed merger, to adopt all tariff schedules currently on file with this Commission on behalf of Pacificorp Maine.

3. The merged company, Pacificorp Oregon, d/b/a Pacific Power & Light Co., shall, upon consummation of the proposed merger, succeed to the utility rights and responsibilities of Pacificorp Maine under the public utility laws of Montana and the orders of this Commission.

4. The Pacific Power & Light Co. shall, as necessary, promptly advise this Commission of any substantial deviations from the anticipated structure and operations of the merged company as outlined by the testimony in this proceeding. The Montana Consumer Counsel shall also be so advised.

5. The objections filed by Pacific Power & Light Co. to data requests submitted by CREDA are made moot by this Order.

6. All other motions and objections not otherwise ruled upon are denied.

Done and Dated this 8th day of June, 1988 by a vote of 4-0.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

CLYDE JARVIS, Chairman

HOWARD L. ELLIS, Commissioner

TOM MONAHAN, Commissioner

DANNY OBERG, Commissioner

ATTEST:

Carol Frasier
Commission Secretary

(SEAL)

NOTE: Any interested party may request that the Commission reconsider this decision. A motion to reconsider must be filed within ten (10) days. See ARM 38.2.4806.